

Message Text

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ACTION EB-07

INFO OCT-01 AF-06 ARA-06 EUR-12 NEA-10 ISO-00 ERDA-05

AID-05 CEA-01 CIAE-00 CIEP-01 COME-00 DODE-00 FEAE-00

FPC-01 H-02 INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01

PM-04 USIA-06 SAM-01 OES-03 SP-02 SS-15 STR-04

TRSE-00 PA-01 PRS-01 (ISO) W
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P R 211359Z JAN 76

FM AMEMBASSY LUSAKA

TO SECSTATE WASHDC PRIORITY 2677

INFO AMEMBASSY BELGRADE

AMEMBASSY BRASILIA

AMEMBASSY BUENOS AIRES

AMEMBASSY CAIRO

AMEMBASSY ISLAMABAD

AMEMBASSY KINGSTON

AMEMBASSY KINSHASA

AMEMBASSY LIMA

AMEMBASSY MEXICO CITY

AMEMBASSY NEW DELHI

AMEMBASSY YAOUNDE

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EO 11652: N/A

TAGS: EFIN, ENRG, ZA

SUBJECT: CIEC: IMPACT OF HIGHER OIL PRICES ON ECONOMIC DEV-
M ELOPMENT

REF: STATE 006381

1. SUMMARY: DIRECT IMPACT ON ZAMBIA OF HIGHER OIL PRICES,
WHILE SIGNIFICANT, IS DWARFED BY MUCH GREATER, THOUGH LESS
EASILY QUANTIFIABLE, INDIRECT IMPACT VIA CONTRIBUTION OF HIGHER
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ENERGY COSTS TO RECESSION IN INDUSTRIALIZED ECONOMIES.

RESULTING DEPRESSED DEMAND FOR COPPER HAS HAD DISASTROUS EFFECTS ON COPPER PRICES AND ZAMBIA'S FOREIGN EXCHANGE POSITION. GRZ MADE SERIOUS MISCALCULATION IN EARLY 1970'S WHEN IT ENCOURAGED GREATER USE OF HEAVY FUELS RATHER THAN LOCALLY AVAILABLE COAL IN MINING INDUSTRY. BOTH GRZ AND MAN ON STREET HAVE RELATIVELY SOPHISTICATED UNDERSTANDING OF ZAMBIA'S INTERDEPENDENCE WITH INDUSTRIALIZED ECONOMIES. DESPITE MOST SERIOUS ECONOMIC CRISIS SINCE INDEPEMCENCE 11 YEARS AGO, OFFICAL DISCUSSION OF LARGELY EXTERNAL CAUSES OF CRISIS HAS BEEN DEVOID OF DEMAGOGUERY DIRECTED AGAINST EITHER INDUSTRIALIZED COUNTRIES OR OIL PRODUCERS. FULL IMPACT ON GENERAL POPULATION WILL BE FELT WITH VENGEANCE DURING 1976. INFLATIONARY PRESSURES HAVE BEEN HELD REASONABLY WELL IN CHECK THROUGH MASSIVE SUBSIDIZATION PROGRAM OF BASIC COMMODITIES, A PROGRAM WHICH WILL HAVE TO BE ABANDONED THIS YEAR BECAUSE OF COST. END SUMMARY.

2. BETWEEN 1972 AND 1975, ZAMBIA'S IMPORT BILL FOR PETROLEUM PRODUCTS ROSE FROM \$16 MILLION TO AN ESTIMATED \$83 MILLION BOTH BECAUSE OF THE INCREASE IN COST (FROM \$3.40 PER BARREL PRIOR TO OCTOBER 1973 TO AN AVERAGE OF \$11.60 IN 1974) AND BECAUSE OF INCREASED VOLUME. AS PERCENTAGE OF IMPORTS PETROLEUM ACCOUNTED FOR ONLY 2.8 PERCENT IN 1972 BUT ROSE TO 9.7 PERCENT IN 1975.

| YEAR | VOLUME (MILLION BARRELS) | FOB VALUE | PERCENTAGE OF TOTAL IMPORTS |
|------|-----------------------------|-----------|--------------------------------|
|------|-----------------------------|-----------|--------------------------------|

| | | | |
|------|---------|--------------|-----|
| 1972 | CRUDE-- | \$16 MILLION | 2.8 |
| | REFINED | 3.6 | |

| | | | | |
|------|---------|-----|--------------|-----|
| 1973 | CRUDE | 2.5 | \$26 MILLION | 4.8 |
| | REFINED | 4.0 | | |

| | | | | |
|------|---------|-----|--------------|-----|
| 1974 | CRUDE | 3.4 | \$71 MILLION | 8.8 |
| | REFINED | 2.8 | | |

| | | | | |
|------|---------|-----|-------------|-----|
| 1975 | CRUDE | 4.1 | \$83 FLLION | 9.7 |
| | REFINED | 3.1 | | |

SHOULD BE NOTED THAT ABOVE PETROLEUM COST INCREASES SOMEWHAT UNDERSTATED DUE TO SHIFT IN COMPOSITION OF OIL IMPORTS AWAY FROM LIMITED OFFICIAL USE

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HIGHER VALUE REFINED TOWARD INCREASED PROPORTION OF CRUDE FOLLOWING GOING ON STREAM OF ZAMBIA'S INDENI REFINERY IN 1973.

3. ZAMBIA IS IN RELATIVELY FORTUNATE ENERGY POSITION WITH ABUNDANT HYDROELECTRIC AND THERMAL (COAL) ELECTRICITY GENERATING CAPACITY. ONLY 25 PERCENT OF ENERGY SUPPLY PRODUCED FROM HYDROCARBONS. COMMISSIONING OF KARIBA NORTH BANK POWER STATION DURING 1976-1977 WILL BRING TOTAL INSTALLED HYDROELECTRIC AND THERMAL

CAPACITY TO OVER 1400 MW COMPARED WITH PRESENT DEMAND OF UNDER 1,000 MW. THUS ZAMBIA, ALTHOUGH HAVING NO PROVEN OIL RESERVES OF ITS OWN, HAS LEEWAY TO REDUCE DEPENDENCE ON OIL IMPORTS OVER LONGER TERM. IN SHORT TERM, THERE ARE MAJOR CONSTRAINTS TO REDUCED CONSUMPTION. ABOUT 60 PERCENT OF TOTAL ENERGY DEMAND COMES

FROM MINING INDUSTRY. MARGINAL SAVINGS COULD BE MADE THROUGH RATIONING OR OTHER CONSERVATION MEASURES BUT ONLY AT ADMINISTRATIVE COSTS INCOMMENSURATE WITH POTENTIAL SAVING. GASOLINE CONSUMPTION APPEARS TO BE HIGHLY PRICE INELASTIC. IN RETROSPECT GRZ MADE MAJOR MISCALCULATION WHEN INEARLY 1970'S, AT THEN PREVAILING PRICE RATIO BETWEEN IMPORTED OIL AND DOMESTIC COAL, IT SAW ECONOMIC ADVANTAGE IN USING IMPORTED OIL IN MINING INDUSTRY. GRZ ENCOURAGED SHIFT AWAY FROM COAL. TO IMPROVE ECONOMIC ADVANTAGE, ZAMBIA CONSTRUCTED \$40 MILLION OIL REFINERY IN 1973. SUBSEQUENT OIL PRICE INCREASES REVERSED ECONOMIC ADVANTAGE OF OIL VS. COAL. ZAMBIA IS THUS SADDLED WITH OIL REFINERY WHICH WAS VIABLE UNDER PRE-OCTOBER 1973 PRICES BUT ECONOMICALLY INEFFICIENT TODAY. FURTHER, TECHNOLOGY OF OIL REFINING POSES MAJOR RESTRAINT ON ZAMBIA'S ABILITY TO SHIFT AWAY FROM USE OF HEAVY FUELS. INDENI REFINERY IS CONSTRUCTED TO PRODUCE INDUSTRIAL FUELS IN RELATIVELY FIXED PROPORTIONS - INCLUDING 22 PERCENT OF OUTPUT IN HEAVY FUELS, FOR WHICH THERE IS NO MARKET OTHER THAN MINING SECTOR. REFINERY

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TRSE-00 PA-01 PRS-01 /115 W

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P R 211359Z JAN 76

FM AMEMBASSY LUSAKA

TO SECSTATE WASHDC PRIORITY 2678

INFO AMEMBASSY BELGRADE

AMEMBASSY BRASILIA

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IS EXPLORING WAYS OF CHANGING OUTPUT MIX IN FAVOR OF WHITE FUEL BUT CAPITAL COSTS OF CHANGE MAY PROVE PROHIBITIVE. BANK OF ZAMBIA CALCULATES COST OF PRODUCTION OF COPPER ROSE \$16 PER TON AS DIRECT RESULT OF OIL PRICE INCREASES.

4. SERIOUS AS DIRECT EFFECTS HAVE BEEN, INDIRECT IMPACT ON ZAMBIA FROM COMBINED EFFECTS OF INFLATION AND RECESSION IN DEVELOPED COUNTRIES ON ZAMBIA'S TRADE ACCOUNT HAVE BEEN DISASTROUS. WE HAVE NO WAY OF CALCULATING WHAT COPPER PRICES MIGHT HAVE BEEN WITHOUT OIL PRICE INCREASES BUT ASSUME OIL PRICE INCREASES
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HAVE DELAYED ECONOMIC RECOVERY IN INDUSTRIALIZED COUNTRIES AND THUS HAD SIGNIFICANT IMPACT IN DELAYING RECOVERY OF COPPER MARKET, WHICH ACCOUNTS FOR OVER 90 PERCENT OF ZAMBIA'S FOREIGN EXCHANGE EARNINGS. ZAMBIA, WHICH ENJOYED \$620 MILLION TRADE SURPLUS IN 1974, WILL HAVE TRADE DEFICIT OF UP TO \$200 MILLION IN 1975 AND PERHAPS SIMILAR DEFICIT IN 1976. BANK OF ZAMBIA ESTIMATES UNIT VALUE FOR ALL IMPORTS INCREASING AT ANNUAL RATE OF 20-30 PERCENT DUE TO INFLATION IN DEVELOPED COUNTRIES. THUS BECAUSE OF COMBINATION OF HIGHER IMPORT COSTS, LOWER EXPORT EARNINGS DUE TO DEPRESSED COPPER PRICES, HIGHER COSTS OF FUEL IMPORTS, AND INCREASED FREIGHT COSTS, ZAMBIA CAN EXPECT TO RUN BOP DEFICIT ON CURRENT ACCOUNT IN RANGE OF \$500-800 MILLION IN 1976. (TOTAL GDP ABOUT \$1.8 BILLION.)

5. IMPACT OF WORLD RECESSION ON ZAMBIA DELAYED BOTH BECAUSE OF LONG LAGS IN WORKING PRICE INCREASES THROUGH TO CONSUMER AND MAJOR GOVERNMENT EFFORT TO CUSHION EFFECTS OF INFLATION THROUGH MASSIVE SUBSIDIZATION OF KEY CONSUMER COMMODITIES. IN 1975 GRZ SPENT \$128 MILLION -- ABOUT 17 PERCENT OF TOTAL EXPENDITURES--ON CONSUMER SUBSIDIES. FERTILIZER SUBSIDIES ALONE COST GRZ \$51 MILLION IN 1974 AND MAIZE SUBSIDY ANOTHER \$27 MILLION. SINCE MID-1975 BUT WITH INCREASING INTENSITY SINCE BEGINNING OF 1976, GRZ HAS BEEN ENGAGED IN MAJOR EFFORT TO EDUCATE POPULACE ON CAUSES OF HARDSHIPS TO COME. EDUCATIONAL CAMPAIGN IS AIMED AT PREPARING ZAMBIANS FOR ELIMINATION OF CON-

SUMER AND OTHER SUBSIDIES WITH RESULTING ESCALATION IN COST OF LIVING AND TO ENCOURAGE GREATER EFFORTS PROMOTE CONSERVATION AND SELF-SUFFICIENCY IN FOOD PRODUCTION. COMMON THEME IS INTERDEPENDENCE WITH DEVELOPED COUNTRIES WHICH HSAW EFFORTS AT ECONOMIC RECOVERY SET BACK BY OPEC PRICE INCREASES. ZAMBIANS HAVE CLEAR AWARENESS OF DEPENDENCE ON HEALTHY ECONOMIC IN WEST FOR HIGH COPPER EARNINGS. HOWEVER, LINK BETWEEN OPEC PRICE INCREASES AND DEPRESSED COPPER PRICES PROBABLY LESS CLEAR TO MAN IN STREET.

6. GIVEN MULTIPLICITY OF PROBLEMS FACING ZAMBIA FROM FORCES NOT OF ITS MAKING -- WORLD INFLATION, TRANSPORT PROBLEMS DUE TO ANGOLA CCWIL WAR, AND LOW COPPER PRICES--AND INTER-RELATED CHARACTER OF THOSE PROBLEMS, RELATIVE IMPORTANCE OF OIL PRICE INCREASES IN BRINGING ZAMBIA TO ITS PRESENT GRIM PLIGHT DIFFICULT TO SORT OUT. LOW COPPER PRICE IS CLEARLY OVERRIDING LIMITED OFFICIAL USE

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IN IMPORTANCE. FOREIGN EXCHANGE RECEIPTS FROM COPPER FELL FROM \$1,379 MILLION IN 1974 TO \$826 MILLION IN 1975. PROSPECT FOR 1976 IF PRICE UNCHANGED AND TRANSPORT BOTTLENECKS CONTINUE IS FOR COPPER RECEIPTS IN RANGE OF \$650 MILLION.

7. FINANCING OF FUEL IMPORTS HAS POSED NO PROBLEM AS COMMERCIAL BANKS REGARD THIS AS SAFEST FORM OF CREDIT. WE GET IMPRESSION THAT FOREIGN-OWNED BANKS COMPETE FOR THIS BUSINESS PARTLY TO PREEMPT GRZ REQUESTS FOR SUBSTANTIAL EXTERNAL FINANCING FOR GENERAL BOP ASSISTANCE. GRZ HAS ALSO DRAWN ON IMF OIL FACILITY. IN 1975, GRZ WAS FORCED TO BORROW TOTAL OF \$450 MILLION, OF WHICH REVOLVING CREDITS FOR FUEL IMPORTS WAS LESS THAN 20 PERCENT. TOTAL FINANCING REQUIREMENTS FOR 1976 WILL EXCEED \$600 MILLION, OF WHICH ABOUT 12 PERCENT WILL BE FOR OIL.

8. ALTHOUGH THERE HAS BEEN SOME PRIVATE GRUMBLING, OFFICIAL CRITICISM OF OPEC COUNTRIES HAS BEEN RESTRAINED BOTH BY FOREIGN POLICY CONSIDERATIONS AND FOR FEAR OF ANTAGONIZING WHAT GRZ STILL CONSIDERS AS POTENTIAL SOURCE OF EXTERNAL FINANCING. GRZ WOULD THEREFORE BE UNLIKELY TO ASSOCIATE ITSELF WITH VOCAL CRITICISM OF OPEC BLOC AT CIEC.

9. DEPARTMENT MAY WISH ALSO REVIEW IMF REPORT EDU/75/412 OF NOVEMBER 18, 1975 RELATED TO ZAMBIA'S REQUEST FOR PURCHASE UNDER OIL FACILITY.
WILKOWSKI

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